United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

6-13-77

76-7607

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Docket Nos. 76-7607, 76-7619

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UNIVERSITY HILL FOUNDATION,

Plaintiff-Appellee and Cross-Appellant,

-against-

GOLDMAN, SACHS & CO.,

Defendant-Appellant and Cross-Appellee.

Appeal From the United States District Court
For The Southern District of New York
(71 Civ. 1166 (MEL))

REPLY BRIEF FOR APPELLANT
BRIEF FOR CROSS-APPELLEE
GOLDMAN, SACHS & CO.

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REPLY BRIEF FOR APPELLANT
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GOLDMAN, SACHS & CO.

University Hill's brief demonstrates that the errors in the opinion of the court below result largely from the failure of University Hill to present at trial any evidence on a series of critical issues. Goldman, Sachs was held liable for violating a court-imposed standard of care; but there was no testimony and no documentary evidence (other than that supporting Goldman, Sachs) as to the proper standard to be applied. Goldman, Sachs was held liable on the further ground that if it had adhered to the imposed standard

of care, it would have uncovered certain documents; but these documents were offered in evidence without any testimonial support, any proof of what function they served or any indication of how or why they would have been available to Goldman, Sachs under any circumstances. In addition, the trial court seems finally to have concluded, at least by implication, that if Goldman, Sachs had adhered to the standard imposed by the court it would have found that Penn Central was not creditworthy; but this ultimate conclusion is also without record support.

The total absence of competent evidence in support of the position of University Hill and the legal error of the court in imposing an onerous standard of conduct in the absence of such evidence requires reversal.

I. THERE IS NO EVIDENTIARY OR LEGAL SUPPORT FOR THE STANDARD IMPOSED BY THE DISTRICT COURT

The trial court imposed a significant burden of investigation upon Goldman, Sachs by requiring that in the circumstances of this case a commercial paper dealer must verify -- in part by demanding detailed internal documentation of a preliminary nature -- the statements made to it by the chief financial officers of the borrowing company. University Hill Foundation v. Goldman, Sachs & Co., 422

F. Supp. 879, 902 (S.D.N.Y. 1976) In its initial brief before this Court Goldman, Sachs argued that the imposition of such a standard -- a composite of the duties implied by the "shingle theory" and the statutory duties of an underwriter -- was unsupportable by the language of § 12(2) of the 1933 Act, by the prior views of this Court in Franklin Savings Bank v. Levy* or by other relevant case law.

In response, University Hill has utterly misstated Goldman, Sachs' position and proceeded to refute an argument not made. It is not Goldman, Sachs' position that it is exonerated merely by reason of the fact that its opinion that Penn Central was creditworthy was honestly held. Goldman, Sachs acknowledges, as it has since the outset of this litigation, that its sale of the commercial paper of a particular issuer is an implicit representation that it has made the customary commercial paper credit investigation and concluded that the issuer in question is creditworthy. Based largely upon this concession, the trial court decided that Goldman, Sachs would be liable to University Hill if it had not performed that investigation and analysis reasonably and adequately. Goldman, Sachs does not take issue with that theoretical conclusion in this appeal. Rather, it has sought

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* 551 F.2d 521 (2d Cir. 1977).

to bring before this Court the question of whether the expansive obligations of verification imposed by the trial court in the name of reasonabless and adequacy are appropriate as a matter of law. It is Goldman, Sachs' contention that they are not. This contention is based upon the statutory analysis set forth in our initial brief on appeal (at 15-25), upon the limited nature of the implied representations made to University Hill regarding Goldman, Sachs' ordinary practices and upon the uncontradicted evidence that Goldman, Sachs' conduct was reasonable under the circumstances and adhered to what was expected in the industry.

II. THERE IS NO EVIDENCE THAT THE INVESTIGATION AND ANALYSIS CONDUCTED BY GOLDMAN, SACHS WAS INADEQUATE OR UNREASONABLE

A. Plaintiff Presented No Evidence As To The Proper Standard Against Which Goldman, Sachs' Conduct Should be Measured

Like the district court, University Hill erroneously assumes that "adequate" and "reasonable" have some fixed meaning that can be applied to commercial paper credit analysis without reference to any evidence of how such an analysis should be conducted.

Apart from its use of Goldman, Sachs deposition testimony, University Hill called no witness on the issue of the proper standard of investigation in commercial paper

analysis; it called no witness to describe the financial condition of Penn Central; and indeed it called no witness with any experience in commercial paper credit analysis whatsoever. Goldman, Sachs, by contrast, called to the stand its own personnel who are clearly experts in commercial paper credit analysis. Those witnesses testified at length regarding the analysis that was done, the reasons why that analysis was sufficient and the reasons why it satisfied them of the creditworthiness of Penn Central.* No witness challenged that testimony and it stands uncontradicted on the record in this case.

Goldman, Sachs also called (by way of deposition and prior trial testimony) two bank lending officers who had responsibility for Penn Central during the relevant time period -- John J. Sullivan, a senior vice president of Manufacturers Hanover Trust Company and John Corrigan, a vice-president of First National Bank-Chicago. Those two banks were major lenders of funds to Penn Central and were among the numerous banks which determined to lend additional funds to Penn Central (directly in the case of First National Bank-Chicago and via Penn Central's wholly-owned subsidiary in the

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* See, e.g., Wilson Tr. 854-56; Vogel Tr. 493-94, 548-54. Goldman, Sachs' explanation of its credit analysis is summarized in its Post-Trial Memorandum at pages 71-103, 124-140 and in Appendix A.

case of Manufacturers Hanover) during the six-week period between the announcement of Penn Central's 1969 fourth quarter results and the date of University Hill's commercial paper purchase. The testimony of both these witnesses supports Goldman, Sachs' position that its conclusions were reasonable and were based upon the kind of information that is considered sufficient by experts in credit analysis (Sullivan, FSB Tr. 855, 868-69, 871-72; Corrigan Dep. 5-7, 12-14, 23; Ex. BY). Indeed the documents submitted in evidence through the testimony of Mr. Sullivan showed that Manufacturers Hanover was satisfied to obtain information virtually identical to that obtained by Goldman, Sachs.* The testimony of Sullivan and Corrigan was likewise unrebutted by University Hill and, with Goldman, Sachs' own testimony, stands as the only evidence on the reasonableness and adequacy of Goldman, Sachs' conduct.

The extraordinary silence of University Hill in the face of this evidence is a proper basis for an inference that Goldman, Sachs' conduct conformed to industry practice and that, in the absence of evidence to the contrary, industry practice was an appropriate standard of behavior:

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* Exs. AD & ET. The one document actually given the banks and not given Goldman, Sachs (Ex. AA) confirms that if Goldman, Sachs had asked for additional information in writing it would have received a document entirely consistent with what it was told orally.

> "The SEC adduced no evidence, and makes no argument, that it or any stock exchange of which [defendant] was a member had proposed a prophylactic practice of this sort or that it was common in the industry. Had such a practice existed we would have expected the SEC to have been zealous in showing it; and, of course, the Commission had the burden of proof. Accordingly, we think that the lack of proof of any specific industry practice . . . . argues in [defendant's] favor and is relevant to the issue of negligence."

SEC v. Geon Industries, Inc., 531 F.2d 39, 52 (2d Cir. 1976) (emphasis added) (footnote omitted). This Court went on in Geon to note that although it is possible to find that conduct is negligent despite its conformity with industry practice, in that circumstance the burden is on plaintiff to show that the standard of the whole industry must be upgraded. This University Hill has also not done. Accord, Manheim v. Wood, Walker & Co., Fed. Sec. L. Rep. (CCH) ¶ 95,848 at 91,089 (D. Conn. 1976) (Lumbard, J.).*

University Hill apparently tries to use testimony of LeMay of Union Bank (Brief at 27-28) to fill the gap

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* The usefulness of expert testimony in these circumstances was recently recognized by this Court in Marx & Co., Inc. v. Diners' Club, Inc., 550 F.2d 505 (2d Cir. 1977) where the Court held that "testimony concerning the ordinary practices of those engaged in the securities business is admissible under the same theory as evidence concerning the ordinary practices of physicians or concerning other trade customers: to enable the jury to evaluate the conduct of the parties against the standards of the ordinary practice in the industry. See VII Wigmore On Evidence § 1949, at 66 (3d ed. 1940)." Id. at 509 (footnote omitted).

caused by its failure of proof on the proper standard of conduct. The testimony of LeMay shows at most, however, that Union Bank expected Goldman, Sachs to do exactly what it did -- review public information and maintain contact with management in order to obtain what additional information it believed necessary. (LeMay, Tr. 65-68.) University Hill nevertheless attempts to construct an argument that LeMay expected Goldman, Sachs to conform to the standard imposed by the trial court. This argument is nothing but speculation unrelated to any finding of the trial court and unsupported by any evidence. University Hill first argues that LeMay "assumed/expected" Goldman, Sachs to conduct a credit investigation. It then seeks to draw an "inference" from that assumption, combined with evidence of certain internal procedures at Union Bank, that it "can further be assumed" that Goldman, Sachs would review the information it obtained. Upon the basis of this edifice of assumptions and inferences, University Hill then suggests that "it can reasonably be concluded that the Foundation expected Goldman, Sachs to conduct precisely the kind of credit investigation required of Goldman, Sachs by the District Court." (Brief at 28)

University Hill has thus attempted to parlay LeMay's rather simple understanding of the commercial paper market into an anticipatory comprehension of the precise standard of care which the District Court imposed. There is simply no

basis for this in the testimony of LeMay whose statements -- elicited by counsel from Goldman, Sachs -- actually show only that he was aware that Goldman, Sachs accumulated information on Penn Central but, in accordance with the usual and necessary practice in this market, did not convey it to investors. (LeMay, Tr. 65-68) There is nothing to indicate an expectation or understanding -- much less a representation by Goldman, Sachs -- that any particular kind of investigation or analysis would be performed.

Further, after attempting to use the testimony of LeMay as a basis for demonstrating the expectation of University Hill, plaintiff then discounts the importance of LeMay's understanding, saying (Brief at 29) that Goldman, Sachs has cited no authority in support of the proposition "that the duty of reasonable investigation is, or should be, predicated upon the expectations of the purchaser or the market in general." If correct, this conclusion leaves University Hill with no evidence whatsoever on the proper standard of investigation or analysis.*

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* Expectations of the purchaser are of some relevance because they may reflect understanding of implied representations by the dealer. This Court's decision in Franklin Savings Bank v. Levy provides the most obvious authority for the proposition that the duty of investigation -- to the extent it exists -- is predicated upon representations understood by the purchaser. 551 F.2d at 527. It is only because the implied representation relates to its credit investigation and analysis that the reasonableness of Goldman, Sachs' conduct is in issue at all.

With due respect for the general experience of the trial court, it is submitted that without guidance from an expert witness or anyone having knowledge of the standards in the industry, and in the face of the contrary testimony of Goldman, Sachs and two eminent bankers, it had no basis in this technical area of credit analysis for contradicting the testimony of defense witnesses (1) that Goldman, Sachs' credit people conducted an investigation that in their expert judgment was sufficient, (2) that in their judgment at the time further investigation would not have been fruitful, and (3) that their conclusions were reasonable and made on an adequate basis.*

B. University Hill's List of Findings and Evidence Does Not Demonstrate the Inadequacy of the Investigation Performed

University Hill's only substantive argument regarding the investigation conducted by Goldman, Sachs is its double list, appearing at pages 30-32 of its brief, showing items which the Court found were not investigated and other

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* By converting the disclosure requirements of Section 12(2) into obligations of investigation and analysis, the court below in essence created a cause of action for malpractice. That being so, the absence of expert opinion evidence on complex technical issues (among which credit analysis of the sixth largest corporation in the United States is certainly one) is ordinarily fatal. Wall v. Brim, 138 F.2d 478, 480-81 (5th Cir. 1943); McDermott v. Manhattan Eye, Ear & Throat Hospital, 25 N.Y.2d 20, 24, 27, 203 N.E.2d 469 (1965); VII Wigmore on Evidence § 2090 (3d ed. 1940 and Supp. 1975).

items which University Hill claims support the contention that Goldman, Sachs should have conducted some other or different investigation. Nowhere does University Hill explain why Goldman, Sachs should have conducted itself in the manner suggested. There is no explanation of what Goldman, Sachs would have learned had it conducted a further investigation* or how the conclusion reached by Goldman, Sachs was wrong. For example, there is no discussion whatsoever either in the Court's opinion or in University Hill's brief of the specific conclusions reached by Jack A. Vogel, Goldman, Sachs' chief credit analyst. Vogel explained in unchallenged testimony that on the basis of his analysis there was a $600 million "cushion" of assets which could have been sold or pledged to raise cash to pay commercial paper as it became due. Vogel testified that the identification of such a "cushion" was the proper method of credit analysis, and there is no testimony to the contrary. Vogel further testified as to the basis on which he reached the conclusion that such a cushion existed in the case of Penn Central and this testimony too was unchallenged.**

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* The only possible exceptions to this conclusion are discussed in Section III, infra.

** Although this brief on appeal is not an appropriate vehicle for describing again the details of the uncontradicted evidence offered by Goldman, Sachs regarding the financial condition of Penn Central as it was known at the time, the Court may wish to refer to Appendix A of Goldman, Sachs' Post-Trial Memorandum which consists of a detailed analysis of the basis upon which Goldman, Sachs reached the conclusion that Penn Central was creditworthy.

Rather than attack the only evidence in the record describing the attributes of a reasonable credit analysis, University Hill simply argued that there were a whole series of actions that Goldman, Sachs did not take. There are, of course, many such actions. Goldman, Sachs did not ask for an accounting of how many tickets each subsidiary railroad sold to commuters, nor did it ask for the electric bills for Grand Central Terminal or the price of conductors' uniforms. The question, however, is not what Goldman, Sachs might have done but what it should have done. And this requires not a laundry list, but an analysis of standards based upon practices and practicalities. This kind of examination is entirely lacking in the trial court's decision -- for the obvious reason that there was no evidence offered by University Hill on which to base it.

In sum, the trial court's conclusions, and University Hill's effort to support them, represent the risks of hindsight analysis at their worst. The methodology of the court and of University Hill has been to pick out certain pieces of adverse information and, with the certain knowledge that Penn Central filed for reorganization in June 1970, to conclude that these items should have made Goldman, Sachs disbelieve the chief financial officers of Penn Central, reject its own methods of analysis and

ignore the conclusions of the entire financial community at the time. There is no basis for such requirements in fact or in law. The imposition of liability on this basis confirms the wisdom of the concurring opinion of Judge VanGraafeiland in Franklin Savings Bank v. Levy:

> "Requiring the defendants to prove "in the bright gleam of hindsight", [citing Judge Friendly concurring of Texas Gulf Sulphur] that they exercised reasonable professional care in arriving at their erroneous opinion, places upon them an almost insuperable burden."

551 F.2d at 530. Here Goldman, Sachs made an investigation and analysis not only in good faith, but in conformance with the standards which the evidence shows to be applicable. The trial court ignored that evidence and imposed its own standard without reference to industry practice, expert testimony or parallel experiences of others in similar circumstances. Its conclusions are without evidentiary support and should be reversed.

III. UNIVERSITY HILL HAS FAILED TO SHOW HOW THE SUPPOSEDLY INADEQUATE INVESTIGATION MADE BY GOLDMAN, SACHS CAUSED IT INJURY

Having imposed a standard of care which is a composite of the most onerous aspects of the duties of underwriters and of brokers, the District Court then held that the supposed failure of Goldman, Sachs to meet that standard rendered false the implied statement that Goldman, Sachs had

conducted a reasonable credit analysis of Penn Central. Apart from the fact that the standard itself is erroneous, the imposition of liability upon the basis of that "false statement" is improper for two additional interrelated reasons: (1) it is error to conclude that a negligent course of conduct can be a basis for liability regardless of whether the exercise of due care would have averted the injury; and (2) it was further error to conclude that Goldman, Sachs ought reasonably to have uncovered certain additional information regarding Penn Central, namely Exs. PX-101, -102 and -103.

A. University Hill Has Failed to Show a Causal Connection Between Its Injury and the Supposed Deviation from the Standard Imposed by the Court.

The Court below concluded that the central issue was not what Goldman, Sachs would have learned had it adhered to the standard set out by the Court, but rather whether Goldman, Goldman, Sachs "discharge[d] its duty reasonably to inquire and to render its representation that it did so investigate true." 422 F. Supp. at 904. University Hill attempts to support this conclusion, arguing in essence that even if a credit analysis that was faultless by the Court's standard would have uncovered no more than what Goldman, Sachs uncovered, liability should still be imposed. (Brief at 38)

The superficial logic of University Hill's position derives from its attempt to extract a double advantage from the manner in which the Court below interpreted § 12(2) of the 1933 Act. University Hill would have the Court impose a standard of conduct for substantive acts -- as opposed to disclosure -- which amounts to a requirement of reasonable care, but would not recognize the ordinary prerequisite of causation which is necessary to prevent the imposition of such liability in an arbitrary and capricious manner.

It is submitted that rather than permit such a departure from normal legal standards, this Court -- assuming it imposes a standard of affirmative duty upon Goldman, Sachs such as that required by the Court below -- should require plaintiff to establish a causal relationship, as in tort law, between breach of duty and injury.* At common law, as this court has observed, "a negligent actor is responsible only for harm the risk of which was increased by the *negligent aspect* of his conduct." *Petition of Kinsman Transit Co.*, 338 F.2d 708, 724 n.9 (2d Cir. 1964) (Friendly, J.) (emphasis original) Thus for example, an automobile driver will not be held liable on the basis that he exceeded the speed limit if

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* At least since *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968) *cert. denied*, 394 U.S. 976 (1969), this Court has recognized the necessity of considering securities laws questions against the background learning of the common law of torts. *See* *TSC Industries, Inc.* v. *Northways, Inc.*, 426 U.S. 438, 445-46 (1976).

a child darts suddenly into the road in front of the car and the resultant accident would have been unavoidable regardless of defendant's speed. Despite the driver's excessive speed, the injury is simply not caused by the negligent aspect of his conduct. 2 F. Harper & F. James, The Law of Torts § 20.5, at 1148 (1956) and cases there cited.

Notwithstanding University Hill's effort to distinguish this Court's decision in Jackson v. Oppenheim, 533 F.2d 826, 830 & n.8 (2d Cir. 1976), that decision is relevant on the issue because it stands for the proposition that causation is prerequisite to a finding of liability under § 12(2). In Jackson, the alleged wrongdoing was an omission to state certain specific facts about the issuer, and accordingly, the causal nexus required was between a statement from which facts were omitted and the investment decision of plaintiff. Here it is claimed that the falsity of Goldman, Sachs' statement arose not from any specific omission of information about the issuer, but rather from its supposedly negligent conduct. In these circumstances liability should be imposed only when the negligent behavior in question would be a basis for liability -- assuming that the statute imposed a standard of substantive duty rather than of disclosure.

Converting the alleged breach of the standard of care into a "false" statement to the effect that the standard

was not breached, is mere verbiage. What the Court below accomplished was the imposition of liability without causal nexus.

In opposition to the recognition of such a causal requirement, plaintiff cites DeMarco v. Edens, 390 F.2d 836 (2d Cir. 1968), where this Court held that liability should be imposed upon a defendant even though the misleading statement occurred in a confirmation not received until after plaintiff's investment decision had been made. In Jackson v. Oppenheim, however, this Court held that the DeMarco situation is "entirely different" because liability in such cases "can be understood as an ancillary enforcement mechanism for the requirement in SEC Rule 256(a)(2) that the offering circular be sent prior to confirmation of payment." 533 F.2d at 830 n.10. In other words, in DeMarco a prophylactic rule was imposed which related only to the proper use of prospectuses, and not to all allegedly misleading statements made in connection with a sale of a security.*

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* Analysis is also not advanced by plaintiff's citation of Eagle v. Horvath, 241 F. Supp. 341 (S.D.N.Y. 1965), where the Court held that defendants "cannot accomplish by deception what they might have accomplished honestly and then be heard to say that the deception was not the cause." Whatever the rule may be in cases involving actual fraud, such a rule is not applicable here where there has been a finding of honesty and good faith. 422 F. Supp. at 894-95, and there is no challenge to that finding on appeal.

(Footnote continued on next page)

It is also significant that University Hill does not address in its brief the United States Supreme Court's most recent discussion of causation in a securities law context, Santa Fe Industries, Inc. v. Green, 51 L. Ed. 2d 480, 492 n.14 (Mar. 23, 1977). In that case, involving alleged non-disclosure and misrepresentation in connection with a short form merger under Delaware law, the Court noted that the plantiffs had not indicated how they would have acted differently if there had been full disclosure of the intended merger. The Court went on to hold "indeed [plaintiffs] accept the conclusion of both courts below that under Delaware law they could not have enjoined the merger . . . . Thus the failure to given advance notice was not a material

(Footnote cont'd)

University Hill's reliance upon Mills v. Electric Auto Lite Co., 396 U.S. 375 (1970) is equally misplaced. In Mills, the Supreme Court held that preservation of "corporate suffrage" required a limited presumption of causation in injunctive actions by shareholders challenging materially deficient proxy statements addressed to them by management. Mills thus merely recognizes that corporate shareholders are legally injured when management calls upon them to act upon such a proxy statement, whether or not the proposal to which the statement relates is itself fair and desirable. Mills does not suggest that in the context of § 12(2) -- or Rule 10b-5 -- a plaintiff can recover on the basis of a "false" statement, the falsity of which is not shown to have any causal connection with plaintiff's investment decision. See Kohn v. American Metal Climax, Inc., 458 F.2d 255, 289 (3d Cir.) (Adams, J., concurring and dissenting), cert. denied, 409 U.S. 874 (1972).

non-disclosure within the meaning of the statute and of the Rule." Id.

Although Santa Fe is couched in terms of materiality rather than causality, the principle is the same: where the alleged breach of obligation could have made no difference, there is no liability. Thus the ordinary requirement of causation cannot be evaded merely by implying a false statement that the standard was not breached and interposing liability based upon plaintiff's supposed reliance upon that statement. Such an argument simply shifts the focus from causation to materiality: if a statement is rendered false solely because of a negligent act that had no consequences, it is immaterial. Santa Fe Industries, Inc. v. Green, 51 L. Ed. at 492 n.14. See also Gilbert v. Nixon, 429 F.2d 348, 358 (10th Cir. 1970).

B. The Trial Court's Reliance Upon Exhibits 101-103 Constitutes Evidentiary and Substantive Error

1. There is no evidence that Goldman, Sachs could have discovered documents in the form of PX 101-103.

As an apparent alternative to its conclusion that deviation from the standard of care is a basis for liability regardless of causal nexus, the trial court briefly explored the question of what Goldman, Sachs would have learned if it

had adhered to the standard imposed. Relying almost exclusively upon Exs. PX 101-103 -- three documents which appear to be in the form of earnings projections, based upon unknown assumptions and to be used, if at all, for unknown purposes -- the Court said, in essence, that if Goldman, Sachs had made a proper investigation, it would have found these three documents. As shown in our initial brief on appeal (pp. 43-50) these documents were erroneously admitted in evidence and in any event there is no testimony which supports the court's conclusions nor is there anything on the face of the documents which in any way suggests that they were available to Goldman, Sachs under any circumstances.

The sum total of what is known about PX 101-103 may be summarized as follows:

1. One Thomas Asay, an employee of Penn Central who is an office manager in the legal department and who had no financial responsibilities whatsoever during the relevant time period (FSB Tr 55-56), found the documents in his post-reorganization document search for purposes of litigation and various governmental investigations. Except for the fact that he found them, Asay knew nothing whatsoever about the pieces of paper offered in evidence. (FSB Tr. 82-83)

2. David C. Bevan, Chairman of the Finance Committee during the relevant time period, said of the documents that "they are not in what I remember as the regular form." (Bevan Dep. Tr. at 171-72).

3. Robert G. Wilson, head of the commercial paper department of Goldman, Sachs, testified that, in his experience, PX 101-103 are not the

kinds of documents nor do they reflect the kind of information ordinarily shared by a commercial paper issuer with its dealer and furthermore that in his judgment they are not the kinds of material upon which substantial reliance should be placed. (Wilson Tr. 897-98, 1027-28)

4. John J. Sullivan, Senior Vice President of Manufacturers Hanover Trust Company and the senior officer having responsibility for Penn Central loans by the second largest bank lender of funds to Penn Central, testified that documents of the type of PX 101-103 are not ordinarily seen by a lending bank determining whether to lend money to a borrower. (FSB Tr. 866-67, 904-10)

In its responsive brief, University Hill has pointed to no evidence that documents in this form are sought or reviewed as part of a commercial paper or any other credit analysis, thus confirming that the only evidence in the record supports Goldman, Sachs' contention that PX 101-103 would not have been obtainable by it at the time.*

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* In support of its position University Hill argues that Goldman, Sachs witnesses testified that they were never denied access to the kinds of information which they sought in the course of making a credit analysis and had they been so refused, they should have stopped selling (Brief at 42). Plaintiff implies that this testimony supports the conclusion that <u>whatever</u> Goldman, Sachs sought, it would have obtained. This does not follow. Certainly if Goldman, Sachs had asked to see the personnel files of Penn Central, this request would have been denied on the basis that it was outside the proper scope of a credit analysis. It is also not self-evident that documents of the sort here in question are within that scope or would have been requested -- after all, we are confronted with three documents culled by subpoena after the fact from a warehouse of documents. The only real evidence is that internal and changing projections are not the kind of documents which are given out, if that is what these exhibits really are.

As previously noted, the trial court nevertheless concluded that it had "no reason to doubt that the Company would have provided this kind of information to Goldman, Sachs . . . ." 422 F. Supp. at 904. This conclusion, by negative inference without any supporting evidence, renders the applicability of the shifting burden of proof under § 12(2) an issue of critical importance.

Section 12(2) places upon the defendant the burden of demonstrating that it could not in the exercise of reasonable care have discovered any particular fact which is found to have rendered misleading a statement made to a plaintiff. Goldman, Sachs, however, made no statements about first quarter projections, and the Court specifically held that Goldman, Sachs made no omissions of particular factual items of the kind contemplated by § 12(2). 422 F. Supp. at 895-96. Rather the Court held that as part of Goldman, Sachs' obligation to live up to its implied representation that it had made an adequate credit investigation, Goldman, Sachs should have searched for and uncovered PX 101-103.* The conclusion does not, however, bring the documents in question within the portion of § 12(2) which shifts the burden of proof to

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* As previously discussed, the evidence actually suggests that if Goldman, Sachs had sought written verification it would have received Exhibit AA which confirms the oral statements of Bevan and O'Herron.

defendant. This is because Goldman, Sachs was held liable on the basis that its supposed statement that it had conducted a thorough credit investigation was false, and plaintiff has the initial burden of proving that falsity. If the failure to discover the documents is what made the statement false, then University Hill was required to show that Goldman, Sachs could have and should have uncovered them. This it utterly failed to do.*

2. PX 101-103 were improperly admitted in evidence.

Apart from the fact that there is no evidence in the record that Goldman, Sachs could have or should have discovered PX 101-103, the documents themselves should not have been admitted in evidence. Whether the basis upon which they should have been excluded be labelled lack of authenticity or hearsay, it is apparent from the record that

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* In Franklin Savings Bank v. Levy this Court appeared to suggest that the burden of proof lay upon the defendant Goldman, Sachs to establish that its credit investigation was reasonable. It appears to have done this on the basis that there was a representation as to the "quality" of the paper being sold and that that representation of "quality" was false. That conclusion in turn appears to have been based upon the finding of Judge Metzner, the trial judge in Franklin, that "when Goldman, Sachs sold this paper, it was understood that it was holding out the paper as credit-worthy and high quality". 406 F. Supp. at 46-47. There was no similar finding by Judge Lasker who held only that the statement that Goldman, Sachs had made a reasonable credit analysis was a false statement.

the necessary identification and explanation of the documents is wholly lacking.*

University Hill argues that the documents in question are admissible as business records (Fed. R. Evid. 803(6)) on the ground that they come from a Penn Central file, appear on their face to have been issued on a periodic basis and need no other supporting evidence. (Brief at 45-49) Although University Hill cites a number of cases which permit the admission in evidence of "records" kept by corporations, each of the cases cited involved not projections, which are inherently based upon a variety of imponderables, but actual notations of past transactions and occurrences. Thus for example in United States v. Ragano, 520 F.2d 1191, 1200 (5th Cir. 1975), the court admitted into evidence documents which were wholly different from those at issue here: an annual corporate report, a certificate of amendment to the articles of incorporation and an application for a license -- all documents

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* Plaintiff claims that Goldman, Sachs has waived its authenticity objection because, at page 1056 of the transcript, counsel for Goldman, Sachs stated that its motion to strike the exhibit was not based on authentication. (Brief at 44) The fact is, however, that at page 1053 Goldman, Sachs had moved to strike a series of exhibits including PX 101-103 on the ground that they were "totally unexplained, no evidence offered, no explanation given, . . ." Whether or not that is an authentication objection, the point was made clear in the record: Goldman, Sachs objected that there was an insufficient explanation of the exhibits to justify their admission in evidence.

filed with various regulatory authorities. The court in Ragano specifically noted that the business record rule would exclude documents which would themselves "be mere cumulations of hearsay or uninformed opinion." The distinction betwen the documents in Ragano and PX 101-103 is significant. There is a general understanding in the business community as to the function of annual reports and it is hardly surprising that a court permitted their admission into evidence. Here the documents are wholly unexplained and there is no indication of the assumptions that were made in creating them.*

University Hill also argues that Goldman, Sachs could have called to the stand one or more of the addressees of the cover memoranda of PX 101-103 and cross-examined such witnesses about the content of the documents. This argument is again premised upon an erroneous assumption as to the burden of proof and the burden of going forward in this situation. Goldman, Sachs called, by way of deposition testimony, David Bevan, Chairman of the Finance Committee of Penn Central and the chief financial officer of the Railroad.

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* The other cases cited by University Hill are distinguishable on the same basis. United States v. Tellier, 255 F.2d 441 (2d Cir. 1958), cert. denied, 358 U.S. 821 (1958) (records of transactions); Carrol v. United States, 326 F.2d 72, 77 (9th Cir. 1963) (records of purchases); United States v. Quong, 303 F.2d 499 (6th Cir. 1962), cert. denied, 371 U.S. 863 (1962) (orders and shipments of materials).

Bevan testified that the documents were not in what he remembered as being the regular form. Bevan testified further that when actual first quarter losses were announced, they "stunned" him, thus indicating that the documents had not served the internal function of giving advance warning to management that University Hill seems to assume was the case (Bevan Dep. 57).

Goldman, Sachs submits that the burden of proof in these circumstances is upon the plaintiff. As previously indicated, the issue is whether Goldman, Sachs' statement that it made a reasonable credit analysis is false. For University Hill to establish that premise it must show that Goldman, Sachs should have uncovered these or similar documents. To demonstrate that point it should certainly have been required to show what these documents were.* Having failed to do so, it should not now be permitted to put upon Goldman, Sachs the burden of explaining away this unidentified material. Furthermore, even if Goldman, Sachs had some

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* A recent example highlights the danger. A draft opinion by a judge may suggest how the judge, or the court, was thinking if no explanation is given. But it may be that the judge asked one law clerk to write a draft opinion coming out one way, and asked another law clerk to write a draft going the other way in order to assist in the decision. In the absence of testimony, the wrong draft would be as misleading as an unexplained internal projection by an unknown officer of Penn Central prepared for an unknown purpose.

initial burden of proof, the burden of going forward was shifted to University Hill by the testimony of Bevan that the documents were not in the regular form, and the further testimony of Wilson and Sullivan that these were not documents of the kind ordinarily sought or which would be received in connection with a credit analysis. (Bevan Dep. 171-72; Wilson, Tr. 896-99, 1024-27; Sullivan FSB Tr. 866-67, 904-10)

Finally, plaintiff argues that regardless of whether the documents are established as business records, they should be admissible to show "that if GS was aware of such information (whether it was true or not, i.e., if Penn Central's state of mind was one of expectation of large losses for the first quarter of 1970), it would have been significant to GS in connection with its opinion of Penn Central's creditworthiness. . . ." (Pl. Brief at 50) The documents on their face do not show Penn Central's state of mind but, at most, the views of someone in the finance department of Penn Central perhaps transmitted to some other people within the company. Had plaintiff wished to establish Penn Central's "state of mind" it could have called responsible Penn Central officers and questioned them in that regard. Rather than run the risk of having additional statements such as Bevan's testimony that he was "stunned" by the first quarter results, however, plaintiff chose to offer unexplained documents in

evidence and hope that the court would draw the desired inference.

In sum, the trial court admitted these documents in evidence without proper identification and explanation, and compounded that evidentiary error by imposing upon Goldman, Sachs the burden of proving that these documents -- drawn from among the thousands of railroad documents subpoenaed in the course of the Penn Central commercial paper litigation -- were unimportant. The district court in the end committed substantive error by concluding, largely on the basis of this evidence, that the representation made by Goldman, Sachs regarding its credit investigation was false. Without these documents and without the unfair burden being imposed upon Goldman, Sachs to explain them, the evidence in support of the trial court's conclusion is minimal and completely outweighed by the testimony of Goldman, Sachs' witnesses.*

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* In an attempt to avoid this conclusion, plaintiff argues (a) that Goldman, Sachs should have known that Penn Central lacked "adequate contingency planning" and (b) that in any event nothing would have caused Goldman, Sachs to change its opinion of Penn Central. Neither of these points is sufficient to cure the defects of the trial court's treatment of Exhibits 101-103. As to contingency planning, the court's conclusion, 422 F. Supp. at 904, that "inquiry would have revealed the situation" is utterly without record support. The blue sheet memoranda of February 5 and 6, 1970 (PX-11 and PX-12), on the contrary, show that Goldman, Sachs was given significant information about the contingency plans of Penn Central. The testimony of Goldman, Sachs' witnesses (e.g. Wilson, Tr. 902-04) and of Sullivan (FSB Tr. 870-72) that they had reason to be satisfied with the information is not challenged by any evidence.

(Footnote continued on next page)

SUMMARY OF GOLDMAN, SACHS' RESPONSE TO UNIVERSITY HILL'S "CROSS-APPEAL"

At the outset it must be pointed out that University Hill has abandoned (or waived) any claim of error with respect to that portion of the judgment of the trial court that exonerated Goldman, Sachs under § 10(b) of the 1934 Act.* The only basis for liability on both the appeal and cross-appeal is § 12(2) of the 1933 Act.

(Footnote cont'd)

Plaintiff also refers to the trial court's suggestion (explicitly not a basis for the court's opinion) that because Goldman, Sachs witnesses were unable to answer, on the spur of the moment, the Court's speculative and somewhat casual question as to what might have persuaded them that Penn Central was uncreditworthy, the procedures followed were therefore inadequate. See Tr. 937-38 cited by the Court. 422 F. Supp. at 901 The Court specifically said that "our findings in so sense depend upon" this conclusion and this must necessarily have been so, since there was no issue or evidence as to the financial condition of Penn Central in April, May and June of 1970 up to the time of the petition for reorganization.

* This is clear from a reading of University Hill's brief. For example, University Hill makes no argument that at trial it had proved the requisite scienter under § 10(b), although such scienter is clearly required, Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), and there was a specific finding that Goldman, Sachs acted without scienter. 422 F. Supp. at 894-95. In any event, there are serious questions (i) whether commercial paper is a security for purposes of the 1934 Act, Franklin Savings Bank v. Levy, 551 F.2d 521, 527-28 (2d Cir. 1977), and (ii) whether an implied private right of action exists under § 10(b) in the circumstances of this case where an explicit cause of action is permitted under § 12(2), Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 752-54 (1975).

In that part of its brief dedicated to its cross-appeal, University Hill quarrels with two findings of fact resolved against it: (i) that certain alleged omissions were neither material nor "necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading" and (ii) that Goldman, Sachs' statement that Penn Central's commercial paper was rated "Prime" by NCO was not a misrepresentation of a material fact. Both these issues arise under § 12(2) and, accordingly, could have been argued by University Hill as appellee without the necessity of taking a cross-appeal.* In view of University Hill's abandonment of any claim other than that based on § 12(2), its cross-appeal is superfluous. See Terkildsen v. Waters, 481 F.2d 201, 204-06 (2d Cir. 1973).**

In arguing its "cross-appeal," University Hill largely attempts to focus the attention of the Court upon evidence in the trial record which it deems favorable to its

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* Dandridge v. Williams, 397 U.S. 471, 475-76 n.6 (1970).

** The situation here is the reverse of that presented by Foman v. Davis, 371 U.S. 178, 181 (1962), where an appeal was allowed despite a technical defect in the notice of appeal because the appellant demonstrated an intent to appeal by, among other things, briefing and arguing the point. Here, the notice of appeal while apparently not defective has been superseded by University Hill's lack of intent in pressing any claim that § 10(b) liability should have been found. See Daily Mirror, Inc. v. New York News, Inc., 533 F.2d 53, 56 (2d Cir. 1976).

position. In this attempt it disregards voluminous contrary evidence which the trial court found compelling and, more important, ignores the fact that crucial issues of credibility were resolved against it at trial.

In pursuing this tack University Hill chooses to ignore that this is not a case where the evidence at trial consisted largely of documents and deposition testimony which might be reexamined by this Court. Much of the deposition and documentary evidence was relevant only, or at least primarily, to background matters and issues not in serious dispute. Evidence concerning University Hill's view of materiality and its complete lack of a relationship with Goldman, Sachs; evidence concerning the agency relationship between University Hill and Union Bank; and evidence bearing on the reasons and motives for Goldman, Sachs' actions for the most part consisted of oral trial testimony. Zenith Corp. v. Hazeltine, 395 U.S. 100, 123 (1969); Fed. R. Civ. P. 52(a).

While we will attempt in this brief to set in perspective the major factual disputes raised by University Hill -- all of which were the subject of extensive post-trial briefing -- we respectfully submit that this Court need not and should not review all of those disputes on this appeal. Each of the findings of the District Court challenged by University Hill is supported by the substantial weight of

the evidence, and each was made by a consideration of the entire record, including assessments of credibility that ought not now be reconsidered. Pampillonia v. Concord Line, A/S, 536 F.2d 476, 477 n.2 (2d Cir. 1976).

In order to limit the space which need by devoted to these factual issues -- which ought not to have been raised on appeal at all -- Goldman, Sachs has cited in this brief to the extensive factual discussion in its Post-Trial Memorandum which treats in detail each of the issues raised by University Hill and which the trial court found persuasive in its consideration of this evidence.

IV. THE TRIAL COURT CORRECTLY FOUND THAT NONE OF PLAINTIFF'S ALLEGED OMISSIONS WERE, IN THE LANGUAGE OF SECTION 12(2), "NECESSARY IN ORDER TO MAKE THE STATEMENTS, IN LIGHT OF THE CIRCUMSTANCES UNDER WHICH THEY WERE MADE, NOT MISLEADING"

In Plaintiff's Post-Trial Brief, University Hill correctly set forth the requirements of proof under § 12(2) relevant here:

> "[F]or an action to be founded on § 12(2) of the '33 Act, a false statement must be made or a fact must be omitted which is necessary to make the statements made not misleading . . . . [I]t will be shown that the facts omitted by Goldman, Sachs were necessary to make these statements [described earlier] not misleading."

Plaintiff's Post-Trial Brief at 48-49. Later in the same brief, University Hill set forth the elements it was required

to establish in order to prove Goldman, Sachs had violated § 12(2). Among those elements was:

> "(3) The omitted fact was necessary to make the statements made by Goldman, Sachs not misleading."

Id. at 61. Thus, University Hill has conceded, as indeed it must, that § 12(2) does not impose a general duty to disclose all "material" facts (as it now disingenuously argues), but rather that the duty is only to disclose those "material" facts which should be disclosed in order not to render "the statements, in light of the circumstances under which they were made, not misleading."

The cases relied upon by University Hill to support its notion of a generalized duty to disclose arose under Rule 10b-5,* which for this purpose is critically different than § 12(2), as it may make mere silence actionable in certain circumstances. The United States Supreme court has recognized this distinction in the context of Rule 10b-5:

> "To be sure the second subparagraph of the Rule [10b-5] specifies the making of untrue statement of a material fact and the omission to state a material fact. The first and third subparagraphs are not so restricted."

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* In fact, plaintiff's principal argument is based on a misreading of Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, 495 F.2d 228 (2d Cir. 1974). Shapiro was concerned with the question of the class of investors to whom a duty was owed and not the question presented here, that is, a question of the scope of the duty owed.

Affiliated Ute Citizens v. United States, 406 U.S. 128, 152-53 (1972); Trussell v. United Underwriters, Ltd., 228 F. Supp. 757, 767 (D. Colo. 1964). See also Superintendent of Insurance v. Bankers Life, 404 U.S. 6 (1971); List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.), cert. denied, 382 U.S. 811 (1965). Because the language of Rule 10b-5(2) tracks that of § 12(2), the Supreme Court's analysis is persuasive indeed.*

A. The Trial Court Correctly Found That Disclosure of the Alleged Omissions Was Not Necessary

Although University Hill has conceded its burden to establish that disclosure of the alleged omissions was necessary in order to make statements made not misleading, in its brief on appeal University Hill simply ignores this critical element of its case.

Strikingly, there is no challenge by University Hill to this finding by the District Court:

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* That § 12(2) is intentionally narrow to avoid imposing a duty to speak is confirmed by the comparison of an early draft which does not contain the words "necessary in order to make the statements, in light of the circumstances under which they were made, not misleading." H.R. 5480, introduced May 3, 1933. The later addition of those words demonstrates a conscious effort by the draftsmen to limit the scope of 12(2) liability. See also SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 867-68 (2d Cir. 1968) (Friendly, J., concurring). Judge Friendly reasoned that under § 17(a), as under § 10b, fraud must be alleged so as not to "totally undermine the carefully framed limitations imposed on the buyer's right to recover granted by § 12(2) of the Act." Id. at 868.

> "[N]one of the alleged omissions can be considered necessary 'in light of the circumstances' unless the omitted facts, of themselves, rendered a judgment that [Penn Central] was creditworthy unreasonable. For the following reasons we find that this is not true of any of the alleged omissions here."

422 F. Supp. at 895-96.

University Hill's entire "cross-appeal" is an attempt to establish the materiality of these omissions, a question this Court need not reach because of a total failure to challenge the finding that these alleged omissions were not "necessary" to have been stated.

B. The Trial Court Correctly Looked To The Circumstances Under Which The Statements Were Made

University Hill does not come forward, as it cannot, to claim that the trial court acted improperly in viewing the circumstances under which Goldman, Sachs' statements were made. Rather, plaintiff insists that the trial court held that "the nature of the commercial paper market created an exception to [Goldman, Sachs'] duty to disclose material facts to [University Hill]." (Brief at 58). In so arguing, University Hill distorts the District Court's holding, as a reading of its analysis on this issue plainly shows:

> "In considering this claim [of a failure to disclose certain discrete facts], one must view it in the context of the special circumstances of the transaction, which relate both to the

> nature of the commercial paper market as a whole and to LeMay's modus operandi within that market. Proof at trial demonstrated that for reasons relating to economics and practicalities peculiar to commercial paper, sales are made by way of hurried phone calls in which there is little or no expectation of unsolicited disclosure of the numerous facts always available as to an issuer's condition. Moreover, it is plain that whatever course other purchasers may have taken, such as inquiring into bank line coverage, LeMay sought no information whatsoever. Apart from ascertaining that the paper was prime (with which we deal separately), he sought only a judgment of creditworthiness and chose to rely on it."

422 F. Supp. at 895. This finding by the trial court -- based upon the expectation, conduct and behavior of the plaintiff as well as the structure of the commercial paper market -- is amply supported by record evidence.*

University Hill also spends a great deal of time obfuscating the true issue by attacking the use of Phillips v. Reynolds & Co., 297 F. Supp. 736 (E.D. Pa. 1969), as precedent. In employing Phillips, the District Court recognized that it arose "[i]n a slightly different but parallel context" before finding that its analysis was "singularly applicable to the facts at hand." 422 F. Supp. at 895.

Phillips is certainly sound precedent since it looks to the relationship between the parties in order to

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* Fitzpatrick, Tr. 106, 113, 118, 121, 125, 128, 130; LeMay, Tr. 14-15, 29, 34, 47-50, 57, 63-69, 77-79, 82-83; Van Cleave Tr. 237, 260, 261, 269, 272-74, 260; Sullivan, FSB Tr. 380-84; Exs. BY, A-21, at 4, Ff; PX-75, at 5; CU. See generally Defendant's Post-Trial Memorandum 42-70.

determine the extent disclosure is required. Section 12(2) expressly requires as much. Moreover, this Circuit has recognized that in determining materiality under § 10(b) of the 1934 Act, account must be taken of all the surrounding circumstances. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968). See also Carras v. Burns, 516 F.2d 251, 256-57 (4th Cir. 1975); Robinson v. Merrill Lynch, Pierce, Fenner & Smith, 337 F. Supp. 107, 112-13 (N.D. Ala. 1971), aff'd per curiam, 453 F.2d 417 (5th Cir. 1972).*

V. IN THE CIRCUMSTANCES OF THIS CASE NO UNDISCLOSED FACT WAS MATERIAL TC THIS PLAINTIFF

A. The Proper Standard of Materiality

University Hill ignores this Circuit's standard of materiality under the securities laws, that is, whether "a reasonable man would attach importance [to the fact misrepresented] in determining his choice of action in the transaction . . . ." List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.), cert. denied, 382 U.S. 811 (1965). This standard

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* "To make this defendant or any other broker the guardian of a customer such as the plaintiff would destroy an important part of the marketplace. In every case a trader could recover damages from his broker merely by proving non-transmission of some fact which, he could testify with the wisdom of hindsight, would have affected his judgment had he learned of it."

337 F. Supp. at 113.

has gained added strength by the United States Supreme Court's pronouncement with respect to the issue of materiality in the related context of suits under § 14(a) of the 1934 Act, 15 U.S.C. § 78n(a). TSC Industries Inc. v. Northway, Inc., 426 U.S. 438, 448-49 (1976). Although that decision was directed at materiality under a different section of the 1934 Act, the logic of the opinion is equally applicable to the concept of materiality under § 12(2) of the 1933 Act. Translating the Court's statement into terms useful under § 12(2), an omitted fact should be deemed material only if there is a substantial likelihood that a reasonable investor would consider the fact important in deciding whether or not to purchase or sell the security in question, or in other words, that the fact would have assumed actual significance in the reasonable investor's deliberations.

> "[T]here must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."

422 U.S. at 449 (footnote omitted).

The reasonable investor posited by this standard does not, of course, exist in a vacuum, and the case law is clear that he is to be placed in the objective position occupied by plaintiff and others who operate in the same securities market in like circumstances. E.g., Rogen v. Ilikon Corp., 361 F.2d 260, 266 (1st Cir. 1966); Gilbert v. Nixon,

429 F.2d 348, 356 (10th Cir. 1970); Taylor v. Smith, Barney & Co., 358 F.Supp. 892, 895 (D. Utah 1973). Accord, TSC Industries, Inc. v. Northway, Inc., 422 U.S. at 448-49. The critical circumstances here include the relationship between University Hill and Union Bank and the investment strategy of University Hill and Union Bank with respect to commercial paper and the commercial paper market generally.

B. The Place for Expert Testimony

The alleged omissions which University Hill claims are material all concern business practices and procedures in the highly specialized commercial paper market, a market which has been judicially recognized as "unique."* And this Court has recognized that the time period encompassed by this lawsuit was one of "significant change" in this unique market.** Matters such as the need for inventory, significance of approved lists, use of bank lines, and the meaning of a "Prime" rating all required expert testimony not just to explain them but, more crucially, to establish the materiality *vel non* of actions involving or affecting them.

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* In re Equity Funding Corp. of America Securities Litigation, 375 F. Supp. 1378, 1385 n.13 (Jud. Pan. Mult. Lit. 1974).

** Franklin Savings Bank, 551 F.2d at 522 n.3.

Plaintiff, however, chose not to proffer expert testimony but to hope that Messrs. Wilson, Van Cleave, Doty and Vogel, undoubtedly all experts on matters relating to the commercial paper market, would provide upon cross-examination the testimony necessary for plaintiff's case. Yet trial did not go as planned by plaintiff and the testimony of these witnesses, as set forth in our Post-Trial Memorandum, plainly establishes, among other things, the non-materiality of plaintiff's alleged omissions.*

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* Instead of meeting foursquare its burden to proffer expert testimony, plaintiff, in scattered references throughout its brief, endeavors to prove the materiality of particular facts by citing to the deposition testimony of Goldman, Sachs witnesses -- usually Levy and Weinberg -- to the effect that particular facts were "important" in some undefined manner, or occasionally, that particular facts are ones that the witness would have desired to know in some hyothetical and undefined purchase transaction.

The questions evoking such responses sought conclusions by non-experts on matters as to which they had no first hand knowledge (Levy Dep. 119, 191-92; Weinberg Dep. 10-11, 191-93) The responses themselves are no more evidence of "materiality" than the statement of a witness having no personal or expert knowledge that a particular act was "reckless" or "negligent." Whether seen as a violation of the so-called opinion rule or as a lack of testimonial capacity, such statements are inadmissible. <u>See</u> Federal Rule of Evidence 701; J. Weinstein & M. Berger, <u>Evidence</u> ¶ 701 [02], at 701-11 & n.4 (1975). <u>See also</u>, Defendant's Post-Trial Memorandum at 142-145.

Moreover, Goldman, Sachs objected to plaintiff's designation of the depositions of Anczarki, Hansell, Harre, Stutt and Brenkart in their entirety on the ground that they are irrelevant to any issue in this case. (<u>See</u> Brief for Plaintiff-Appellee 78).

C. No Undisclosed Fact Was Material

The trial record demonstrates that in the circumstances, none of these claimed omissions was or ought to have been considered material by University Hill. 422 F. Supp. at 895-96. Accord, Alton Box Board v. Goldman, Sachs & Co., 418 F. Supp. 1149, 1151 Ed. Mo. 1976); Phillips v. Reynolds & Co., 297 F. Supp. 736, 738 (E.D. Pa. 1969).

Indeed, the trial court specifically found:

> "[I]t is plain that whatever course other purchasers may have taken . . . [University Hill] sought no information whatsoever. Apart from ascertaining that the paper was prime (with which we deal separately) [it] sought only a judgment of creditworthiness and chose to rely on it."

422 F. Supp. at 895. This finding is telling, if not determinative, in light of plaintiff's oft-quoted authority that a party's "own conduct illustrates the materiality of the information." SEC v. Shapiro, 349 F. Supp. 46, 54 (S.D.N.Y. 1974), aff'd, 494 F.2d 1301 (2d Cir. 1974).*

1. Inventory

As shown in our post-trial memorandum (16-38, 173-80) and as analyzed by the trial court, 422 F. Supp. at 894-96, Goldman, Sachs' reduction in the size of its inventory of

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* This finding also refutes University Hill's unfounded insistence that there was no finding by the trial court on materiality.

Penn Central commercial paper was done for reasons unrelated to the creditworthiness of the company.* This conclusion is established by the specific finding of the trial court that Goldman, Sachs acted throughout in good faith. 422 F. Supp. at 894-95.

Once it is established that the inventory reduction was not the "bail out" that plaintiff claims but a simple business decision which was part of an identifiable policy of some standing, the supposed materiality of the event evaporates. Accord, Alton, 418 F. Supp. at 1157.

Plaintiff relies on Chasins v. Smith, Barney & Co., 438 F.2d 1167 (2d Cir. 1970), in support of the proposition that Goldman, Sachs' action in reducing inventory would have been of interest to University Hill regardless of whether such action constituted actual fraud. It is, however, inherently illogical to require a communication for the sole purpose of allowing an investor to draw a conclusion proven on

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* University Hill has simply ignored the evidence adduced at trial on the reasons for Goldman, Sachs' inventory reduction and would apparently have this Court rule in a vacuum that the simple fact of reduction is per se material regardless of any of the surrounding circumstances. There was substantial evidence before the trial court, however, of Goldman, Sachs' reasons for reducing the inventory of Penn Central. This evidence shows that the correctness of the trial court's finding that the reduction of inventory was not material, 422 F. Supp. at 894-96, was entirely proper. See, e.g., Exs. PX-75, A-110, BI (Jan. 14, 1970), BM, CU, CW, DX, FA, FK, FL; Van Cleave, Tr. 267-69, 275-77, 289-92, 297,307, 309-10, 313-15, 336, 437-38, 443, 451-52; Doty, Tr. 681-97; Wilson, Tr. 1101-03; Lepley Dep. 7-9, 27.

the record to be erroneous. Moreover, plaintiff's line of argument based on Chasins cannot survive the Supreme Court decisions in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), and TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976). By predicating liability upon facts which merely suggested an improper motive, Chasins is inconsistent both with the conclusion of Ernst & Ernst that an actual intent to deceive, manipulate or defraud is necessary and with the conclusion of TSC that the fact must be one which was substantially likely to affect the investment decision in question. Cf. Fridrich v. Bradford, 542 F.2d 307, 319-20 (6th Cir. 1976), cert. denied, 50 L. Ed.2d 769 (Jan. 10, 1977). In TSC, the Court held in part that the non-communication of facts "suggestive" of market manipulation cannot be a basis for liability without "some showing that there was in fact market manipulation." Here, the trial court's finding of good faith and proper business purpose in connection with Goldman, Sachs' inventory policy negatives any suggestion of manipulative intent and, in the words of TSC, "it cannot have been materially misleading to fail to disclose [the underlying facts]." 426 U.S. at 463 To the extent there is contrary reasoning in Chasins requiring disclosure of information merely "suggestive" of wrongdoing, it is overruled by TSC.

Moreover, the Supreme Court in Santa Fe Industries, Inc. v. Green, 51 L. Ed. 2d 480 (Mar. 23, 1977), in the context of a § 10(b) suit, clearly recognized that the policy of full and fair disclosure expressed in the 1933 and 1934 Acts does not reach corporate actions done without deception. Id. at 492-94. Further, the Court expressed a reluctance "to federalize the substantial portion of the law of corporations that deals with transactions in securities . . . ." Id. at 495-96. That learning is especially relevant here, where plaintiff asks this Court to reverse a finding of the trial court based on uncontradicted proof not rebutted by plaintiff at trial by expert or other testimony, that a change in Goldman, Sachs' method of doing business, with no ulterior deceptive motive, was not material.

In sum, the trial court's entirely proper conclusion that Goldman, Sachs acted at all times in good faith rebuts any argument that the inventory reduction -- the only conceivable relevance of which is as a reflection of supposed bad faith -- is material under the standards of TSC.

2. Bank Lines

University Hill further claims that the unwillingness of Penn Central to seek additional bank lines of credit was also a material fact which ought to have been conveyed to it. The trial court on the basis of Mr. LeMay's testimony expressly found to the contrary:

> "[I]t is plain that whatever course other purchasers may have taken, such as inquiring into bank line coverage, LeMay sought no information whatsoever."

422 F. Supp. at 895.

In brief, the evidence below showed that bank lines were a useful financial tool in cash management but were not essential to the creditworthiness of a large company such as Penn Central. (Vogel, Tr. 512-13; Lepley Dep. 33; Defendant's Post-Trial Memorandum 84-93, 160-73). The evidence at trial consistently demonstrated that bank lines are cancellable at will and thus provide little if any protection in times of economic stress. (LeMay, Tr. 55-57, 97; Van Cleave, Tr. 305; Vogel, Tr. 513; Sullivan FSB, Tr. 876-77). Accord, Franklin Savings Bank, 551 F.2d at 523 n.5.

At trial, Mr. LeMay testified that he never asked any dealer what the bank line coverage of an issuer was (LeMay, Tr. 96), and his testimony can further be read as showing a lack of sophistication about bank lines. (Compare LeMay 32, 90-93, with Van Cleave, Tr. 248). Moreover, Mr. Fitzpatrick testified to a complete indifference to any element other than specific maturity date, yield and an NCO rating of "Prime." (Fitzpatrick, Tr. 132). Accordingly, there has been a complete failure of proof by plaintiff on the issue of the materiality of bank lines to an investor in the position of University Hill.

3. The Removal Of Penn Central From The "Approved List" Of Another Goldman, Sachs Customer Is Not Material

University Hill also asserts that the undisclosed fact that Brown Brothers Harriman & Company apparently "temporarily" removed Penn Central from its approved list in early February 1970 was material. Although a Goldman, Sachs "blue sheet" (Ex. F-4, 1305a) does reflect that event, there is not a shred of evidence in the record indicating the basis for that removal or connecting it in any way to a determination by Brown Brothers that Penn Central was not creditworthy.

It was, after all, plaintiff's burden to establish the materiality of the statement. University Hill was free to call an expert to testify about the nature of "approved lists" and "bank lines" in this unique market. Without proferring some testimony, expert or otherwise, University Hill cannot be heard to complain that the trial court determined issues of fact contrary to its position.

Aside from the complete failure of proof by plaintiff, Goldman, Sachs clearly established that the removal by Brown Brothers of Penn Central's name from its approved list was not material. Defendant's Post-Trial Memorandum 180-83.

First, Brown Brothers itself had an unsecured line of credit which was available to Penn Central. On April 30,

1970 -- long after the 1969 results had been announced and a little more than a week after the far more significant first quarter results for 1970 were publicly available -- Brown Brothers lent $2,000,000 of its own money to Penn Central under that line on an unsecured basis, not legally or practically different from a commercial paper note. (Ex. BY)*

Second, there is undisputed testimony about the significance of approved lists, see Franklin, 551 F.2d at 526, which establishes that investors regularly take names on and off approved lists, and unless this action is done for credit reasons it is not material. (Vogel, Tr. 545-46).

Finally, total commercial paper outstandings remained high during the early spring of 1970 up to and past University Hill's purchase. Thus, although an investor which had purchased up to 15 percent of the total amount of commercial paper outstanding was no longer in the market, the market itself was sufficiently resilient to absorb virtually all of the paper that Brown Brothers might otherwise have purchased.

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* That the money lent by Brown Brothers was part of a line of credit did not affect the moral and legal right of any bank to have refused to make the loan in April if dissatisfied with the credit of the borrower. (LeMay, Tr. 55-57; Vogel, Tr. 546-47; Sullivan FSB, Tr. 876).

VI. THE TRIAL COURT CORRECTY FOUND THAT THE STATEMENT BY GOLDMAN, SACHS THAT PENN CENTRAL COMMERCIAL PAPER WAS RATED "PRIME" BY NCO WAS NOT FALSE

The substantial discussion by the trial court showing that Goldman, Sachs did not improperly influence NCO's rating Penn Central commercial paper as "Prime" also answers the argument that the substance of Goldman, Sachs' conversations with NCO ought to have been communicated to Union Bank. 422 F. Supp. at 896-97. As long as NCO's independence is not in question,* the mere fact that NCO's representative spoke to Goldman, Sachs as part of his investigation of Penn Central is certainly not significant.** The trial court agreed, concluding that the conversation was unexceptionable and need not have been conveyed to plaintiff.

University Hill tries to overcome the District Court's analysis of the February 4, 1970 conversation between Rogers and Vogel by saying that the document speaks for itself and further that Vogel's testimony "is simply not believable." This strident claim by University Hill lacks conviction in view of the fact that no trial court considering this issue has agreed with plaintiff's position.

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* *See* *Mallinckrodt Chemical Works* v. *Goldman, Sachs & Co.*, 420 F. Supp. 231, 242 (S.D.N.Y. 1976).

** *See* Defendant's Post-Trial Memorandum 148-60.

In Alton Box, the trial court specifically found:

> "The plaintiff . . . has failed to produce any credible evidence to show that defendant, Goldman, Sachs was responsible for the continued rating of Penn Central commercial paper as NCO "Prime". There is simply insufficient evidence to prove that NCO relied in toto upon the statements of defendant Goldman, Sachs regarding the credit of Penn Central Transportation Company."

418 F. Supp. at 1154. Although Judge Metzner mentiond in Franklin NCO's "reliance" on Goldman, Sachs, he attributed no improper motive or effect to it. Moreover, Judge Metzner's reference to prime occurred only in that part of his decision on 1934 Act jurisdiction. Compare 408 F. Supp. at 42-44, with 551 F.2d at 527-28. Finally, Judge Tenney in the Mallinckrodt case squarely held that NCO had not acted improperly in discussing Penn Central with Goldman, Sachs, and further that NCO had acted competently in analyzing Penn Central's creditworthiness. 420 F. Supp. at 242-43.*

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* In the absence of authority for its position University Hill cites to matters not in evidence, namely the SEC Staff Report entitled "The Financial Collapse of the Penn Central Company" (Ex. PX-113 id.). Without having appealed this point, University Hill belatedly claims that this document is admissible under the official records exception to the hearsay rule, Fed. R. Evid. (803(8). In passing Rule 803(8), however, Congress did not intend to make admissible opinion and conclusion. H.R. Rep. No. 650, 93d Cong., 1st Sess. 14 (1973). Since the Report primarily consists of opinions and conclusions and is cited by plaintiff for just that reason (Brief of Plaintiff-Appellee at 89), it was properly excluded. Kamen & Co. v. Paul H. Aschkar & Co., 382F.2d 689, 698 (9th Cir.

(Footnote continued on next page)

CONCLUSION

For the foregoing reasons, and for the reasons set forth in our principal brief, the judgment of the District Court should be reversed.

Respectfully submitted,

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(Footnote cont'd)

1967), *cert. dismissed*, 383 U.S. 801 (1968); *Kansas City Stock Yards Co.* v. *Reich & Sons*, 250 S.W.2d 692, 700 (Mo. 1952). Moreover, because of the extensive pretrial discovery in this case -- including the production of all transcripts of testimony by Goldman, Sachs before the SEC -- any factual matters set forth in the Report which are relevant to this litigation were available to University Hill to introduce at trial in a fuller and more accurate form not intermixed with hearsay and opinion. Finally, it is difficult to conceive how an evidentiary ruling consistent with the rulings of every trial court which considered this issue during the course of the Penn Central commercial paper litigation could be deemed an abuse of discretion.

Certificate of Service

Service of two copies of the annexed brief was made upon Solin & Breindel, attorneys for plaintiff-appellee by delivering same to Solin & Breindel at 645 Fifth Avenue, Suite 400, New York, N.Y. 10022

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